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No. 83-638

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ALCAN ALUMINIUM LIMITED,
Petitioner,

v.

THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, Operating Through its New York Office; FRANK GOODMAN, Individually, and as District Manager, New York Office of the Franchise Tax Board of the State of California; and JOSEPH E. GOEGHEGAN, Individually, and As Supervisor-Audit Group, New York Office of the Franchise Tax Board of the State of California,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF THE GOVERNMENT OF CANADA AS AMICUS CURIAE SUPPORTING CERTIORARI

DANIEL JOSEPH, P.C.
(Counsel of Record)
RORY F. QUIRK
AKIN, GUMP, STRAUSS, HAUER & FELD
1333 New Hampshire Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 887-4000
Counsel for the Government of Canada as Amicus Curiae

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INTEREST OF AMICUS CURIAE

This case presents important questions concerning the Foreign Commerce Clause of the United States Constitution, which provides that "Congress shall have Power . . . To regulate Commerce with Foreign Nations . . . ."[1] The decision below holds in effect that the application by a State of the United States of a "unitary" method of

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[1] Art. I., § 8, cl. 3.

taxation to the combined worldwide incomes of a domestic subsidiary and its foreign parent does not violate the Foreign Commerce Clause even though the unitary method conflicts with the "arm's length" method used by the United States government and accepted internationally.

The foreign parent in this case is Alcan Aluminium Limited, a corporation organized and existing under the laws of Canada. The decision below imposes significant financial and administrative burdens on Canadian companies engaged (through subsidiaries or otherwise) in trade or other gainful pursuit in the United States. Because of the extensive Canadian investment in the United States,[2] the participation by Canadian corporations in business activities involving both the United States and third countries, and the adverse impact that the decision below will have on those activities, the Government of Canada has a significant interest in the disposition of this petition for certiorari.[3]

SUMMARY OF ARGUMENT

This case, on the merits, presents an issue of great international concern. That issue is whether a State of the United States may, consistently with the Constitution of the United States, apply a unitary method of income taxation to the aggregate worldwide incomes of a foreign parent company, its U.S. subsidiary and all of its foreign subsidiaries for purposes of determining the domestic

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[2] Canadian direct investment in the United States at the end of 1982 exceeded $9.8 billion. Bureau of Economic Analysis, United States Department of Commerce, *Foreign Direct Investment in the United States in 1982*, 63 Survey of Current Business 31, 36 (Aug. 1983, No. 8). Canada accounted for 10 per cent of foreign direct investment in the United States at the end of 1982. *Id.* at 32.

[3] The Department of State has encouraged foreign governments to assert interests of this nature by filing amicus briefs in pending judicial proceedings.

subsidiary's State tax liability.[4] Attempts by California and an increasing number of other States to impose varying versions of such unitary taxation on foreign corporations have provoked protests to the Government of the United States by major trading partners—including the Government of Canada, which has been emphatic in expressing its views on this issue.[5]

Last Term, the Court expressly reserved decision on the constitutionality of this practice when it decided *Container Corporation of America v. Franchise Tax Board.*[6] That case involved the separate issue of the constitutionality of California's unitary taxation of a U.S. parent company and its foreign subsidiaries.[7] California's attempt to reach to the worldwide income of a *foreign* parent company and its foreign subsidiaries raises different and more difficult constitutional questions than the practice sustained in *Container Corporation.*

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[4] As the district court found below, under California's unitary taxation scheme, the separate identities of corporate family members are disregarded and consolidated for purposes of determining the net income of that business. Once this figure is ascertained, the percentages of the business entity's sales, property and payroll within California are averaged. The previously determined net income is then multiplied by the average percentage to arrive at the corporation's tax liability. Petition App. II at A5.

[5] Prime Minister Trudeau expressed the Canadian Government's "serious concern" about this issue in a September 24, 1983 letter to President Reagan. Previously, Finance Minister Marc Lalonde had raised these concerns in a letter to Secretary of the Treasury Regan. On September 28, 1983, the Embassy of Canada reiterated its long-standing concerns to the U.S. Department of State. Similar concerns were raised by the Embassy of Greece on behalf of the Ten European Community Governments (August 1, 1983); the Japanese Government (August 11, 1983); and the Australian Government (November 7, 1983). These notes are reproduced in the Appendix to this Brief.

[6] 103 S. Ct. 2933 (1983).

[7] 103 S. Ct. at 2952 n.26, 2956 n.32.

Those questions go to the very heart of the foreign commercial relationships between the United States and its trading partners—the regulation of which lies squarely and exclusively with the Congress under the U.S. Constitution.[8]

The courts below ruled that Alcan (which they characterized as a mere shareholder of its wholly owned U.S. subsidiary Alcancorp) lacked standing to challenge the constitutionality of California's application of the unitary tax method to the incomes of Alcan and its nearly 100 non-U.S. subsidiaries operating worldwide. The district court purported to base its holding on a finding that Alcan lacked standing and ruled that it would not reach the merits of Alcan's complaint. However, the district court supported its holding on standing by finding that California had only taxed what it was entitled to tax—a holding on the merits—and that the unitary tax applied by the Respondents does not result in multiple taxation of Alcan's foreign income nor result in any burden upon foreign commerce.[9] The court of appeals adopted the district court's opinion as its own, and affirmed.

The Government of Canada finds it anomalous that while the worldwide income of the Alcan group of companies is held eligible for taxation by States of the United States, the parent corporation—a member of the income group which is effectively the subject of taxation—is deemed ineligible to seek review of that taxation method by the courts of the United States.

The Government of Canada submits that the decision below will have a decided and deleterious effect on global trade and investment. That decision flatly contradicts the principles enunciated by the Court in *Japan Line*,

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[8] Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

[9] *See* Pet. App. II at A7-A8, A10.

Ltd. v. County of Los Angeles,[10] and *Container Corporation* in that: (1) the unitary tax scheme sanctioned therein is incompatible with the principles of income allocation utilized by the United States government and by the international community, and exposes the income of Canadian and other foreign companies, which is also subject to taxation by the foreign countries of their commercial domicile, to multiple taxation; (2) the decision below results in a significant and growing burden upon the foreign parent and foreign subsidiaries of multinational corporations, which must compile and submit in varying formats to the States of the United States sensitive financial data on the corporations' extraterritorial activities, thereby further burdening foreign commerce; and (3) the decision below vitiates the ability of the United States to speak with "one voice" in matters of foreign commerce and, by opening the door to other States to adopt similar unitary taxation schemes, invites speaking with a cacophony of voices.

ARGUMENT

I. The Application of California's Unitary Tax Scheme To Foreign Corporations Exposes Them To Multiple Taxation And Thus Imposes A Burden On International Trade and Investment

A recurring issue before this Court in recent years has centered upon the increasing efforts by States of the United States to bring the income earned by affiliated overseas companies into the tax base to which an arbitrary state apportionment formula is then applied. Last Term, in *Container Corporation of America v. Franchise Tax Board*, the Court held that the Constitution does not forbid a State from applying unitary taxation to reach the income earned abroad by the foreign subsidiaries of the U.S. parent company.[11]

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[10] 441 U.S. 434 (1979).

[11] 103 S. Ct. 2933 (1983).

However, the Court expressly reserved decision on the constitutionality of application of the unitary method where the parent company is foreign:

> We have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with *foreign* parents or foreign corporations with either foreign parents or foreign subsidiaries.
>
> . . . .
>
> We recognize that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by *foreign* interests. We need not decide *here* whether such a case would require us to alter our analysis.[12]

Three dissenting Justices stated that an application of unitary taxation to United States activities of a foreign corporation would violate the Constitution.[13] This case involves a Canadian parent, and therefore squarely presents that issue.[14]

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[12] 103 S. Ct. at 2952 n.26, 2956 n.32 (emphasis added).

[13] 103 S. Ct. at 2960 (Powell, J., joined by Burger, C.J., and O'Connor, J., dissenting).

[14] The Government of Canada does not oppose the unitary tax method in principle, nor is it seeking to address herein the relative merits of the unitary method vis-a-vis the arm's length method. Rather, the Government of Canada is complaining of the adverse results caused by simultaneous application of both systems on a Canadian corporation whose operations are generally governed by the internationally accepted arm's length method but whose U.S. operations are subject in California and other States to the entirely different—and irreconcilable—unitary method. For this reason, a reversal by the Court in this case would not affect the prior decisions of the Court with respect to unitary taxation in that the issue here centers on the conflict between two irreconcilable methods of income allocation as opposed to the propriety of those methods.

A. *The Incompatibility of the Unitary Method of Tax Assessment With Generally Accepted Principles of Arm's Length Income Allocation for Tax Purposes Often Results in Multiple Taxation Which Cannot Be Relieved by International Double Taxation Agreements*

At issue here is the clash of two incompatible and irreconcilable methods of income allocation for tax purposes. One method is the internationally accepted "arm's length" approach. The other method is the "unitary business/formula apportionment" method adopted by California and a number of other States of the United States.

Under the arm's length approach, every corporation, even if closely tied to other corporations, is treated for most purposes as if it were an independent entity dealing at arm's length with its affiliated corporations, and is subject to tax only by the jurisdictions in which it operates and only on that portion of its business attributable to the business carried on in that jurisdiction.[15] The unitary system, in contrast, rejects geographical or transactional accounting, treats as one the separate entities—foreign and domestic—that are comprised by an enterprise, and apportions the aggregate income between the taxing jurisdiction and the rest of the world on the basis of an arbitrary formula that can vary from State to State.[16]

As the Court noted in *Container Corporation*, the arm's length method is the international norm adopted by the world community (including the governments of Canada and the United States) for allocating income for tax purposes.[17] It is in accordance with model conventions for the avoidance of multiple taxation adopted by the

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[15] 103 S. Ct. at 2950.

[16] 103 S. Ct. at 2940.

[17] 103 S. Ct. at 2952.

United Nations and the Organization for Economic Cooperation and Development (OECD), both of which expressly rejected formula apportionment (that is, the unitary system) in favor of arm's length allocation.[18] These principles have been adopted by the nations of the world in their double taxation treaties.[19]

As the Court noted in *Container Corporation*, California has adopted a taxing system that represents a "serious divergence" from the internationally accepted taxing method adopted by foreign taxing authorities and preferred by the United States government.[20]

The ramifications of California's using a different system are significant. Most large corporations have profitable as well as less profitable (and some unprofitable) activities. Under the arm's length system, the profitable activities are subject to taxes where profits are made, and the less profitable or unprofitable ones pay less or no taxes in the jurisdictions where they are carried on. The unitary method of income allocation, however, unrealistically implies that individual entities of the entire enterprise (the "unit") have the same level of profitability; for example, in California the amount of taxation in a particular jurisdiction is based on a formula considering only the proportion of property, payroll and sales in that jurisdiction.[21]

In *Container Corporation*, the Court concluded that multiple taxation was possible under both the unitary

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[18] *See* United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 7(2), 9(1), U.N. Doc. ST/ESA/102 (1980); Report of the OECD Comm. on Fiscal Affairs, Model Convention for the Avoidance of Double Taxation With Respect to Taxes on Income and on Capital, arts. 7(2), 9(1) (1977).

[19] *See, e.g.*, U.S. Treasury Department's Model Draft Income Tax Treaty of June 16, 1981, arts. 7(2), 9(1), 1 CCH Tax Treaties ¶ 158.

[20] 103 S. Ct. at 2952.

[21] 103 S. Ct. at 2943.

and arm's length methods, and that it therefore would not "require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation." [22] The Court seems to have suggested that multiple taxation under either system would be more or less random and would occur with equal frequency. This suggestion is incorrect.

First. Multiple taxation or undertaxation engendered by California's apportionment scheme is not mere happenstance; it is *inevitable* because the fundamental assumptions underlying the California scheme allocate income to a given jurisdiction in proportion to the wage rates, property values and sales prices in that jurisdiction (rather than upon the income actually earned in that jurisdiction as calculated by the arm's length method).

Thus, if a corporation earns income in non-U.S. jurisdictions whose wage rates, property values and sales prices are lower than the corresponding rates, values and prices in California,[23] California *systematically* allocates only a proportion of that foreign income to the foreign jurisdiction where it is earned, thereby subjecting the unallocated portion to State tax in California notwithstanding the fact that such income has been taxed by the host country under internationally accepted principles of

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[22] 103 S. Ct. at 2954-55.

[23] This is not an infrequent occurrence. In his report to Congress, the Comptroller General noted that although there have been no definitive studies measuring differences in the values of apportionment factors between the United States and foreign countries, "available evidence from independent researchers does indicate that property values and wages, even after adjustments for productivity differences, may be substantially lower in many foreign countries than in the United States." Report by the Comptroller General to the House Comm. on Ways and Means: Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving 37 (GAO/GGD-82-38 (1982)) (hereinafter Comptroller General's Report).

taxation. The petitioner Alcan's experience provides a vivid illustration of the unavoidable multiple taxation trap created by California's apportionment scheme.

As Alcan demonstrated below, in years when its U.S. operations were unprofitable and its foreign operations showed profits, it nonetheless paid California income tax.[24] Since Alcan's U.S. operations had no net income to tax, the "income" upon which the California tax was based could only have been obtained by California through the allocation of Alcan's foreign income to California pursuant to the California apportionment formula. However, pursuant to accepted international practice, all of this income was also taxed in the country of origin. Thus, Alcan's experience in California leaves no doubt that this result is neither a random occurrence, nor a matter of mathematical imprecision, but is rather a direct consequence of the application of the unitary scheme.

The only conceivable way whereby the California apportionment formula would not result in multiple taxation (or undertaxation) would be if the income allocated to California pursuant to the apportionment formula were *identical* to the income actually earned by the corporation in California. This is at best a very rare event, and it is mere coincidence when it does occur.

This Court has declared that "[e]ven a slight overlapping of tax" upon foreign commerce warrants close scrutiny.[25] Such scrutiny is clearly warranted here.

Second. It is true that differences in the allocation of income and expenses among national tax jurisdictions employing the arm's length method can also result in multiple taxation or undertaxation. However, these differences, being those of inconsistent applications of the same principle, can be eliminated and are susceptible to

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[24] Pet. App. III at 17.

[25] Japan Line, Ltd. v. United States, 441 U.S. at 456.

resolution through international negotiation and bilateral and multilaterally agreed model tax treaties.

By contrast, multiple taxation arising out of the apportionment method occurs because that method has an entirely different principle for deciding where income is earned. This difference is irreconcilable with the international method, and cannot be harmonized with it. Nor is it relieved by double taxation treaties. Only in the rare happenstance where the very different assumptions underlying both systems yield the same result are they consistent with each other.

The Court has held that a State tax is unconstitutional under the Foreign Commerce Clause if it "creates a substantial risk of international multiple taxation." [26] That risk is unavoidable where, as here, two jurisdictions apply fundamentally different methods for allocating profits.

B. *Utilization of the Unitary Tax Approach Imposes A Significant Administrative Burden on Canadian And Other Foreign Corporations*

The unitary apportionment method used by California and other States to allocate income to U.S. offices or subsidiaries of Canadian companies imposes significant administrative burdens on Canadian companies doing business in those States. Under the unitary method, the profit of a foreign company on its U.S. business is derived from a formula taking account of the income of the foreign company and non-U.S. subsidiaries worldwide as well as elements such as the assets, payroll and sales of all such companies. For a foreign multinational company with many subsidiaries in different countries, the submission of financial data for all of these companies to a State of the United States imposes a costly burden.

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[26] Japan Line, Ltd. v. United States, 441 U.S. at 451.

The additional administrative burden results from the need to determine whether foreign corporations should be included in the unitary business group, adjusting foreign financial statements to reflect State income tax laws, and translating multiple foreign currency into U.S. dollars.[27] This burden is extreme in the case of widespread multinational corporations because accounting procedures, language and currencies vary significantly from one foreign country to another. Data may have to be obtained from all subsidiaries (nearly 100 in Alcan's case) operating in numerous foreign countries.[28] The information obtained from foreign subsidiaries is often in a foreign language, requiring translation.[29] The foreign company must also perform a "foreign currency translation" with respect to foreign financial data to achieve comparability between U.S. dollars and various foreign currencies, a procedure the Comptroller General has characterized as "a laborious task." [30] While U.S. multinationals are required under U.S. federal law to file consolidated returns for tax purposes, such a requirement does not otherwise exist for Canadian multinationals under U.S. or Canadian tax laws and thus because of unitary taxation the extra administrative burden on Canada multinationals is significant.[31]

The costs of compliance are compounded by the need to prepare separate returns that conform to the varying State tax accounting requirements of the States presently employing some variant of the California scheme. As the Comptroller General has noted, corporate taxpayers must treat the income tax returns for each State separately, and a multijurisdictional taxpayer would have to

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[27] *See* Comptroller General's Report at 37.

[28] *Id.* at 38.

[29] *Id.*

[30] *Id.* at 39.

[31] *Id.* at 40.

make "still more calculations for every other area where nonuniformity exists . . . ."[32] This problem will only grow if the decision below stands, and additional States adopt the unitary method.[33]

Although this burden falls particularly heavily on Canadian corporations because of their extensive U.S. investments, the problem, like the reach of the unitary system, is global.

Underlying all of this is the element of requiring foreign corporations to disclose detailed, highly sensitive information regarding their worldwide operations in order to comply with the accounting requirements of a State of the United States.

Moreover, the tax—which results in multiple taxation —clearly serves as a disincentive for foreign investment in the United States. If a foreign parent creates a U.S. subsidiary within the borders of California, it exposes its non-U.S. activities to California tax notwithstanding the unprofitability of the new U.S. venture. The only way a foreign corporation could avoid such consequences is to forego or abandon investment in California altogether. The imposition of the unitary tax thus has a chilling effect on the framework established by the United States and its partners to encourage foreign investment and to facilitate international trade.[34]

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[32] *Id.* at 17.

[33] Prior to the Court's decision in *Container Corporation*, ten States applied unitary taxation on a worldwide basis. Following the *Container Corporation* decision, Florida adopted a similar system. According to one Florida legislator, "[i]t was like finding money on the street . . . ." *Florida's Legislature Is Latest To Approve Unitary Tax Law*, Wall St. J., July 19, 1983, at 29, Col. 1.

[34] Many businesses have stated that they have elected not to locate in California, and others have considered withdrawing from California because of the unitary tax. *State Taxation of Interstate Commerce and Worldwide Corporate Income: Hearing Before the Subcomm. on Taxation and Debt Management Generally of the*

C. *Utilization of a Unitary Tax Scheme by the States of the United States Prevents the United States From Speaking With "One Voice" in Regulating Foreign Commerce*

It is a well-recognized and longstanding doctrine of constitutional law that "[i]n international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power."[35] In *Japan Line*, the Court recognized that a State tax on foreign commerce may frustrate the achievement of federal uniformity, and held that such a tax is unconstitutional if it prevents the Federal Government from speaking with "one voice" in international trade.[36] The Court noted that a State tax would frustrate federal uniformity if it created an "asymmetry" in the international tax structure, or other States followed the taxing State's example, thereby subjecting foreign commerce to "varying degrees of multiple taxation."[37] In *Container Corporation*, the

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Senate Comm. on Finance, 96th Cong., 2d Sess. 60, 68-71 (1980). The impact of the unitary tax is illustrated by the recent statement of the vice president of the Sony Corporation of America, which commenced operations in California in 1972 prior to California's adoption of the unitary tax:

> "We were very anxious to make things in America. We had to train people, and they had to master new machines, so productivity is low at the beginning. It was expensive and we lost money, but we did it. Then a few years later the tax people came and said we had so much payroll and property in California that we must pay more tax.
>
> "I said, 'Don't you tax people where they make money?' They said, 'I'm sorry, Mr. Wada, but we tax where you have property and payroll.' I don't understand this."

Unitary Tax Scope Widens, N.Y. Times, Oct. 18, 1983, at D2, Col. 1.

[35] Board of Trustees v. United States, 289 U.S. 48, 59 (1933).

[36] 441 U.S. at 451.

[37] 441 U.S. at 450-51.

Court concluded that the California income tax (unlike the California property tax in *Japan Line*) did not violate the Foreign Commerce Clause because: (i) it did not create an "*automatic* asymmetry" in the international tax structure; (ii) the tax fell upon a *domestic* parent company; and (iii) the issue was therefore one of local rather than international concern in that foreign nations had no significant interest in reducing the tax burden of a domestic U.S. corporation.[38]

The present case involves the specific concerns raised by the Court with respect to the California tax in *Japan Line*, and *contains none of the distinguishing factors* enumerated by the Court in upholding the application of the California tax to United States corporations in *Container Corporation*. Indeed, this case is the very case on which the Court reserved decision in *Container Corporation*.

As shown above, application of the California tax creates an automatic asymmetry in the international tax structure, and the parent company in this case, unlike the parent in *Container Corporation*, is a foreign company located in Canada.

Moreover, if the California scheme stands, it opens the door for more States to impose analogous schemes, thereby creating a myriad of multiple taxation formats, which in turn would result in the United States speaking with "many voices" in the realm of foreign commerce.

In *Japan Line*, the Court, in holding a California tax unconstitutional under the Foreign Commerce Clause, declared: "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." [39]

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[38] 103 S. Ct. at 2955-56.

[39] 441 U.S. at 453.

Here, California, by its unilateral act, has established an income allocation and taxation scheme at variance with the international system. This State-created regulation of international earnings is a compelling reason for review by this Court.

CONCLUSION

For these reasons, the Government of Canada respectfully submits that this Court should grant the writ of certiorari.

Respectfully submitted,

DANIEL JOSEPH, P.C.
(Counsel of Record)
RORY F. QUIRK
AKIN, GUMP, STRAUSS, HAUER & FELD
1333 New Hampshire Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 887-4000
Counsel for the Government of Canada as Amicus Curiae

APPENDIX

[SEAL]

PRIME MINISTER • PREMIER MINISTRE
OTTAWA, K1A OA2

September 24, 1983

Dear Ron,

I am writing to you to express the Canadian government's serious concern about the unitary tax issue which I understand you are now considering.

This method of taxation which permits individual state governments to levy taxes against the world-wide earnings of multinational corporations is, in our view, undesirable. In many cases, it places international enterprises in the position of having to pay tax in one jurisdiction for profits earned (and taxed) elsewhere.

The recent Supreme Court decision in the case of Container Corporation vs the California State Franchise Tax Board has considerably heightened the Canadian government's concerns. In addition to the serious potential for double taxation and the increased administrative costs for business, there is the danger that other states and countries, more occupied with a need for increased tax revenues than with consistent tax standards, may adopt this method.

I realize that the issues involved here are not simple, but I am concerned that this could become a major stumbling block to international business and have an effect on our bilateral economic relations. Accordingly, I

would strongly encourage your decision to be one that would lead to a curtailing of this practice.

Yours sincerely,

/s/ Pierre

The Honourable Ronald Reagan
President of the United States of America
The White House
Washington, D.C.

Minister of Finance Ministre des Finances
Ottawa, Canada
K1A 0G5

Dear Mr. Secretary:

I have recently had drawn to my attention the decision in the case of Container Corporation of America vs the California Franchise Tax Board in which the United States Supreme Court upheld the right of a state to use the unitary method of taxing corporate income.

The unitary method of taxation is a cause of considerable concern to a number of Canadian-based multinational corporations. Their concern arises out of three main considerations. First, the unitary method, by applying an arbitrary allocation formula to the consolidated world earnings of a corporate group, departs from the generally accepted international norm for determining the geographic source of income for tax purposes and gives rise to a serious potential for double taxation. Second, the costs of compliance arising out of the need to prepare consolidated returns that conform to the state tax accounting requirements are particularly onerous for Canadian and other foreign-based companies. Third, there is a concern that the sanction of the unitary method will result in its adoption by an increasing number of states and, possibly, by certain foreign countries as a means of increasing their tax revenues.

I understand that you have indicated recently that you were giving consideration to possible legislative initiatives as a result of the Supreme Court decision. I recognize that the issues involved are both complex and sensitive, but the application of the unitary method of taxation to the foreign source income of non-U.S. companies poses difficult problems for a large segment of the international business community. My purpose in writing is to emphasize the seriousness of those problems and to encourage

you to give urgent consideration to the ways in which they might be resolved.

With all good wishes and kind regards.

Sincerely,

Marc Lalonde

The Honourable Donald T. Regan
Secretary to the Treasury
Washington, D.C.
U.S.A. 20220

[SEAL]

Canadian Embassy Ambassade du Canada

NOTE NO. 481

The Embassy of Canada presents its compliments to the Department of State and has the honour to refer to the unitary method of tax assessment practiced by some state taxation authorities in the United States.

The Department of State will recall that the Canadian Government has expressed its concerns about the use of the unitary tax assessment method on a number of occasions. Briefly, these concerns are:

a) the unitary method, by applying an arbitrary allocation formula to the consolidated world earnings of a multinational corporate group, departs from the generally accepted international standard for determining the geographic source of income for tax purposes. This leaves open the serious potential for double taxation;

b) the costs of compliance arising from the need to prepare consolidated returns that conform to the various State tax accounting requirements for the unitary method are onerous; and

c) the continued use of the unitary method could result in its adoption by an increasing number of States, as well as give rise to its use by certain foreign countries as a means of increasing their tax revenues.

The Government has now become aware of circumstances affecting a Canadian multinational corporation that finds itself in a disadvantageous position as a result of the unitary method employed by the State of California. The case involves AlcanAluminum Limited (Alcan), a Canadian corporation, with a United States subsidiary, Alcan Aluminum Corporation (Alancorp), that has op-

erations in a number of States, including California. The California tax authorities have ruled that Alancorp's income for State taxation purposes should be determined on the basis of the worldwide income of Alcan. As a result of the use of this assessment method, Alancorp has been determined to owe substantially higher tax payments to California State authorities than would normally have been the case. Since the 1965 incorporation of the company in its present form the company has been assessed under the unitary method employed by the State of California a substantial income tax in at least 7 years during which it had low levels of income or losses on its United States federal income tax returns and in its audited financial statements.

Alcan has attempted to pursue its dispute with the California State tax authorities over the use of the unitary method in the United States courts because it has no access to the California State Courts. However, in decisions by both the Southern District Court of New York and the Second Circuit Court Alcan's actions have been dismissed on the ground that the parent corporation had no standing. The Canadian Government finds it anomalous that while the worldwide income of Alcan is held eligible for taxation by States in this Country, the parent corporation—a member of the income group which is effectively the subject of taxation, is deemed ineligible to seek review of the taxation method by the United States Courts.

Alcan is now in a position to file a petition for certiorari on this issue with the United States Supreme Court and will be doing so in the near future. In light of the aforementioned general concerns about the unitary method and the serious potential implications that its practice holds for international commerce and foreign relations, the Government of Canada would urge the

United States Government to file a memorandum as amicus curiae in support of Alcan's petition.

The recent decision of the Supreme Court on Container Corp vs California Franchise Tax Board makes clear that the Court took the absence of a United States Government amicus curiae brief into consideration in its assessment of the foreign policy implications in that case and that the Court considered the absence of such a brief not to be a neutral position. In a case involving the interests of a foreign-based multinational firm, the Administration's assessment of the foreign commerce and relations issues would be especially important for the Court's consideration. The Alcan case has particular relevance to the unitary tax issue and the Container Corporation decision. It is an example of a growing number of cases of concern to Canadian companies which have come to the attention of the Canadian Government.

It is the view of the Canadian Government that the Alcan case presents a useful opportunity to address the foreign commerce issue on which the Supreme Court reserved its position in its recent decision on Container Corp vs California Franchise Tax Board. The record and procedural position of the Alcan case is well-suited to a determination by the Supreme Court of the constitutional merits of the challenge to the unitary method based on the burden imposed on foreign commerce. Moreover, this case, in which it is the foreign parent which seeks a decision on the unitary issue, would seem to hold stronger points for consideration by the Court; it would seem doubtful whether a United States subsidiary of a foreign parent could itself assert the implications of the foreign commerce clause as relevant to the unitary tax assessment issue.

The Embassy is prepared to transmit more details on this case as appropriate.

The Embassy of Canada avails itself of this opportunity to renew to the Department of State the assurances of its highest consideration.

WASHINGTON, D.C.
28 September 1983

[SEAL]

EMBASSY OF GREECE
Washington, D.C.

The Embassy of Greece presents its compliments to the Department of State and, on behalf of the Ten European Community Governments, of which the Government of Greece has now the presidency, it has the honor to forward the attached Note on the problems of the unitary method of taxation.

The Embassy of Greece welcomes the opportunity to renew to the Department of State the assurances of its highest consideration.

Washington, D.C., August 1, 1983

Attached: Note

The Department of State
Washington, D.C.

[SEAL]

UNITARY TAXATION

I. Our governments refer to their note on unitary taxation forwarded to the Department of State by the Embassy of Belgium on 29 June 1982.

II. That note drew the attention of the State Department to the case before the Supreme Court of the Container Corporation of America versus the California Franchise Tax Board and urged as a matter of high priority that the government of the United States should participate in that case as amicus curiae. The decision was handed down by the court on 27 June, 1983, and the court found that application of the unitary business principle by the State of California to Container Corporation and its foreign subsidiaries was proper. A majority of justices held that the fact that no brief had been submitted on behalf of the United States government meant there was no indication that the position taken by the government in the case of the Chicago Bridge and Iron Company still represented its views or that the brief in the Chicago Bridge case applied to the Container case.

III. Although the Supreme Court decision did not apply to US companies with foreign parents, our governments were disappointed by the Container decision. They remain convinced that the unitary basis of taxation with combined reporting, particularly as applied in the international field, is unsatisfactory. Our governments therefore urge that the United States government should give strong support to legislation to ensure that States do not use that method of taxation at least for the subsidiaries of foreign corporations. There are currently two relevant bills in Congress, HR 2918 and S. 1225.

IV. It is particularly important that federal legislation should be adopted at an early stage since

there are already signs that, following the decision in the Container case, other American States not at present using this method are contemplating worldwide combined reporting.

Embassy of Japan
Washington

August 11, 1983

Aide-Memoire

Re: The Unitary Tax System

The Government of Japan wishes to present to the U.S. Government agencies concerned the following views with regard to the Unitary Tax System.

The Unitary Tax System, which has been introduced in California and many other states of the U.S., has put a serious burden and constraint on the management and business activities of Japanese-affiliated companies operating in the U.S. We regard the Unitary Tax System as having the following problems:

—It has been causing international double taxation.

—It requires financial and other documents from the companies concerned, which include not only those of the parent company, but of other affiliated companies all over the world, and thus has imposed a tremendous burden on them.

—It has a discouraging effect on Japanese investment in the U.S., and hampers the sincere efforts by the U.S. and Japanese Governments to actively promote Japan-U.S. investment.

Based on this recognition, the Japanese Government has taken every opportunity to raise this question in such fora as the Japan-U.S. sub-cabinet level meeting and Japan-U.S. Trade Subcommittee, and requested the U.S. Government to take appropriate measures as soon as possible to abolish the Unitary Tax System.

On June 27th, the U.S. Supreme Court decided in the Container Corp. of America *vs* Franchise Tax Board Case, that the Unitary Tax System based upon the worldwide profits of the company concerned, including those of

the overseas affiliated companies, is constitutional. Although the Court decision was not on a case in which the head office is located abroad, we are concerned that the decision would encourage a number of states to newly introduce the Unitary Tax System or discourage the states which already have the System from abolishing it. We wish to reiterate that Unitary Taxation can be a barrier to the expansion and development of Japan-U.S. economic relations, including the promotion of our direct investment.

The Government of Japan, attaching great importance to the U.S. Supreme Court decision of June 27th, again expressed concern over this matter in the Japan-U.S. Trade Subcommittee meeting held this July at Wye Plantation, Maryland. We are encouraged to hear the U.S. Government explain that it is ready to present an amicus curiae brief in cases where diplomatic implication is involved. The Government of Japan strongly wishes that the U.S. Government will support the motion for rehearing, present the amicus curiae brief in connection with the rehearing of this case, and also take the same appropriate measures in connection with other individual cases. The Government of Japan further requests that the U.S. Government take concrete measures as soon as possible, including possible legislative actions, which will lead to the abolition of the Unitary Tax System.

[SEAL]

Note No: 383/83

The Embassy of Australia presents its compliments to the Department of State and has the honour to refer to the application by some States of the United States of the unitary method of taxation of the foreign income of Australian companies conducting business in the United States.

The Government of Australia sees the application of this method of taxation to the overseas income of Australian companies trading in the United States as incompatible with internationally accepted taxation principles embodied in, for example, the model double taxation convention endorsed by the OECD in a recommendation which the United States has approved. Moreover, the same principle which the unitary tax offends is found both in the old and new taxation treaties between the Governments of Australia and the United States.

The method of unitary apportionment raises the real likelihood that economic relations between the United States and other countries such as Australia will be hindered. It creates the possibility of double taxation of income derived from Australian sources of Australian companies carrying on business in the United States. Such Australian companies will be placed in an inequitable position. They would also have to undertake onerous administrative tasks to provide the necessary information to State taxation authorities for assessment of tax liability under the world-wide apportionment formula.

As some Australian companies have already been advised they are liable for payment of unitary taxation, the Government of Australia believes the Government of the United States should take action as soon as possible to minimise the serious implications for international economic relations arising from the application of unitary tax to Australian companies. The need for action is more

pressing in light of the recent Supreme Court decision in Container Corporation of America versus Californian Franchise Tax Board. In this regard the Government of Australia notes that the Supreme Court decision may lead to movement by more State Governments away from the "arms-length" tax method to the world-wide apportionment formula. It also poses the danger of other countries adopting this method of taxation and thus undermining an accepted international basis of taxation.

The Government of Australia notes the establishment of a working group charged with developing Federal policy on the unitary tax problem.

The Government of Australia would appreciate receiving from the Department of State advice on the action of the Government of the United States to resolve the unitary tax problem.

The Embassy of Australia avails itself of this opportunity to renew to the Department of State the assurance of its highest consideration.

[SEAL]

WASHINGTON
7 November 1983